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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

*Israel: Prospects for the Balance of Payments
in the Medium-Term*

State Dept. review completed

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
March 1973

INTELLIGENCE MEMORANDUM

ISRAEL: PROSPECTS FOR THE BALANCE OF PAYMENTS
IN THE MEDIUM TERM

SUMMARY

1. Israel's balance of payments showed large surpluses in 1971 and 1972 after three years of deficits, as follows:

<i>Year</i>	<i>Million US \$</i>
1966	-30
1967	182
1968	-92
1969	-322
1970	-61
1971	163
1972	620

The surpluses should continue through 1975 and beyond at roughly the \$600 million level, if there are no drastic changes in Israel's international relations. Even in the absence of US government loans and grants, Israel probably would run balance-of-payments surpluses of \$150 million to \$200 million in 1973 and in 1974 and some \$350 million in 1975.

2. In short, the Israelis have more economic resources to work with now than at any time since the state of Israel was formed:

Note: Comments and queries regarding this publication are welcomed. They may be directed to [redacted] the Office of Economic Research, Code [redacted]

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- The gap between exports and imports, which had been rapidly widening, has now been stabilized at a manageable level.
- While military expenditures remain high, Israel enjoys an overwhelming military superiority which will not be jeopardized by even a substantial decline in military imports.
- Since the 1967 war, Israel's foreign exchange reserves have doubled to \$1.2 billion and could climb to more than \$3 billion by the end of 1975.
- Even if various elements in this cheerful financial picture should darken, any serious problems in Israel's foreign financial position would stimulate additional aid from world Jewry and friendly governments.

DISCUSSION

Israel's Balance of Payments, 1966-72

3. During 1966-72, Israel experienced an annual average balance-of-payments surplus of about \$65 million. (Table 1 provides a breakdown of Israel's balance of payments for this period.) Foreign exchange reserves, which were \$620 million at the end of 1966, have fluctuated widely, dropping to a low of about \$400 million to 1969 and rising to \$1.2 billion at the end of 1972.

4. In 1965-67, Israel was experiencing an economic recession. Deflationary policies had been introduced by the government early in 1965 to counter a rapidly growing foreign trade deficit. The resulting improvement in the trade balance was achieved at the cost of a sharp reduction in economic growth, domestic investment, and private consumption. By 1966, Israel had reduced its balance-of-payments deficit to \$30 million.

5. The June 1967 war revitalized the domestic economy, a development that normally would have led to renewed difficulties with the balance of payments. In this case, however, Israel's balance of payments improved dramatically. The overall surplus in 1967 rose to \$182 million as a result of large capital inflows (primarily from foreign governments), increased transfer payments, and a reduced deficit on merchandise trade. A portion of the favorable balance in 1967 was attributable to the receipts of funds too late in the year to set up contracts for foreign military deliveries.

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Table 1

Israel: Balance of Payments^a

	Million US \$						
	1966	1967	1968	1969	1970	1971	Estimated 1972
Current account	-440	-531	-718	-864	-1,234	-1,171	-1,000
Merchandise (f.o.b.)	-254	-139	-339	-414	-480	-639	-490
Exports	475	533	649	746	802	977	1,180
Imports	-729	-672	-988	-1,160	-1,282	-1,615	-1,670
Non-monetary gold	-1	-1	0	-4	-4	-6	
Freight and insurance on merchandise	36	39	40	33	61	77	
Other transportation	-39	-32	-42	-48	-72	-39	
Other insurance	N.A.	-11	-11	-13	-16	
Travel	10	-14	34	21	51	120	
Investment income	-59	-69	-71	-78	-118	-108	
Government, n.e.s.	-133	-294	-333	-372	-650	-552	
Defense imports	-116	-283	-249	-334	-624	-525	-500
Other services	N.A.	-11	3	-3	-9	-9	
Unilateral transfers	287	521	435	459	649	798	925
Private	286	532	442	465	666	790	
Government	1	-11	-7	-6	-17	8	
Capital account	149	208	227	123	559	676	695
Private long-term	100	12	39	57	77	311	
Private short-term	-26	-44	-30	-69	-29	-76	
Government long-term	75	240	218	134	511	441	
Balance	-30	182	-92	-322	-61	163	620
Net errors and omissions	-27	-15	-36	-40	-35	-140	

a. Because of rounding, components may not add to the totals shown.

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6. The period 1968-70 was dominated by expansionary policies which resulted in a high level of domestic economic activity and a resurgence of difficulties in Israel's foreign financial position. The deficit on current account expanded rapidly, causing balance-of-payments deficits in all three years despite gains in unilateral transfers and capital inflows. Military imports more than doubled in response to the continued Soviet buildup of Egyptian military strength. Imports of capital goods, raw materials, and consumer goods rose sharply, while within Israel's booming domestic economy resources were diverted from exports to domestic markets. The current account deficit more than doubled during 1968-70, to a record \$1.2 billion. Net capital inflows nearly tripled to \$559 million - mainly from expanded US government loans - and unilateral transfers rose 25% in this period, to \$649 million. However, these inflows failed to cover the current account deficits and Israel suffered combined losses of foreign exchange reserves of \$475 million over the three years. In the course of 1970 the government moved to curb the expansionary pressures.

7. Israel stabilized the current account in 1971 and 1972 and recorded balance-of-payments surpluses in both years. Austerity measures introduced in 1970 slowed the expansion of civilian imports in 1971-72. At the same time, exports of goods and services climbed sharply, led by diamonds, tourism, and investment income. The deficit on current account declined by more than \$200 million. Unilateral transfers rose from \$649 million in 1970 to \$925 million in 1972 because of increases in personal transfers, West German restitution payments, and contributions to the Jewish Agency. Capital inflows also were up from \$559 million to \$695 million in the two years, primarily as a result of increased US loans and US private purchases of Israeli bonds.

Balance-of-Payments Prospects, 1973-75

8. In the absence of drastic changes in its international relations, Israel will continue to maintain a healthy balance-of-payments surplus that could go as high as \$600 million to \$700 million a year during 1973-75.¹ First, the planned rate of economic growth, about 8% per year, is well within the potential of human and material resources. Second, support for Israel from world Jewry shows no signs of weakening. Third, access to foreign credits and investment funds continues strong. Fourth, the bulge in military spending will be past by the end of the period. The only cloud on the economic horizon is inflation, which promises to reach a record

1. The projections of Israel's balance-of-payments accounts made in this memorandum are not official projections but rather estimates based on likely trends affecting each major component of the balance. Official Israeli projections indicate annual balance-of-payments surpluses in 1973 and 1974 of slightly less than \$300 million.

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level of more than 15% in 1973. The 10% devaluation of the Israeli pound -- which coincided with the devaluation of the US dollar in February 1973 -- will offset most of the adverse effects on the balance of payments for the time being. As for the real level of economic activity, current betting is that the government will move cautiously in this election year to dampen the economic expansion. The balance-of-payments projections that follow assume no basic change in the "no war, no peace" situation and no extraordinary fluctuations in the economies of Israel's major trading partners. Table 2 presents major items in the projected balance of payments, and the Appendix supplies the details of the projection.

Table 2

Israel: Major Movements in Balance of Payments

	<i>Million US \$</i>			
	<i>Estimated</i> 1972	1973	<i>Projected</i> 1974	1975
<i>Current Account</i>	-1,000	-1,210	-1,330	-1,130
Exports, goods and services	2,200	2,585	2,975	3,420
Imports, goods and services	-3,200	-3,795	-4,305	-4,550
Unilateral transfers	925	1,020	1,005	1,040
<i>Capital account</i>	695	885	925	770
Net foreign investment	195	200	225	250
Net long-term and medium-term loans	500	685	700	520
Balance	620	695	600	680

Current Account

9. Israel's current account no doubt will continue in deficit. The deficit on goods and services probably will increase during 1973-74 and then decline once again in 1975 (see Table 2). Civilian imports -- approximately 80% of total imports of goods and services in 1972 -- are estimated to rise by more than 20% in 1973 and about 15% in 1974-75. Imports of raw materials and capital goods will continue to be major factors in the increase. Military imports will remain at the high current levels until 1975, when deliveries on major US arms contracts will have been nearly completed. Prospects for exports of goods and services continue to be good; increases for exports as a whole are likely to range from 15% to 18% annually.

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10. Raw materials made up almost two-thirds of the \$1.7 billion of total merchandise imports in 1972. Principal categories were rough diamonds, metals, chemicals, textiles, and plastics. The level of imports of raw materials depends on the growth of Israeli industrial production, on world market prices, and, because several industries using these imports are mainly export-oriented, on demand in the United States and Western Europe. With no important changes in the economies of these trading partners, imports of raw materials are projected to increase more than 50% during 1973-75. About one-fourth of the increase will be from expanded imports of rough diamonds, which are then exported in finished form.

11. Capital goods imports made up about one-fourth of civilian merchandise imports in 1972 and included machinery, vehicles, ships, and aircraft. In the past, imports of capital goods have been the most volatile portion of civilian imports because of wide fluctuations in purchases of ships and aircraft. In 1971, deliveries of ships and aircraft were valued at \$200 million and in 1972 at \$40 million. In 1973 they probably will rise to about \$130 million and in 1974-75 will level off at about \$150 million. Major purchases for future deliveries include three Boeing 747 aircraft, several large container ships, and at least three supertankers. Imports of other capital goods, particularly machinery, will increase by as much as 60% in the period 1973-75 if past trends prevail.

12. Consumer goods imports made up only a small part of total civilian imports in 1972. Reduced tariffs and sharply increased disposable income should give a healthy boost to consumer goods imports, particularly in 1973. Although government policy favors restriction of consumer goods imports, 1973 is an election year and a tightening of regulations on consumer goods imports is hardly likely. Moreover, even a doubling of this small category of imports over the three-year period would not seriously affect the overall balance of payments.

Defense Imports

13. Defense imports made up about 21% of Israel's total imports in 1972. Direct military imports - arms and equipment - totaled \$500 million, the lowest level since the post-1969 arms buildup began. Most of the direct military imports were the advanced F-4 and A-4 fighter aircraft from the United States, financed by US military credits. Israel's indirect

2. Figures on merchandise imports in this section are calculated on a c.i.f. basis and are not adjusted to the balance-of-payments definitions used in the tables.

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military imports, consisting of parts and material inputs for its own growing defense industry, reached \$170 million in 1972, compared with \$40 million in 1965.

14. Defense imports probably will increase slightly in 1973, will level off in 1974, and will decline in 1975. Direct military imports, according to Israeli data, will be about \$550 million in both 1973 and 1974, unless the Middle East situation heats up. In 1975, direct military imports probably will plummet to \$300 million when US deliveries of fighter aircraft near completion. In addition, the government faces some internal pressure to reduce military outlays. Indirect imports are projected to remain at the 1972 level of \$170 million. It is possible, however, that indirect imports will increase if Israel succeeds in marketing its own military products abroad.

Services Imports

15. Imports of services for civilian use, which represented about one-third of total imports in 1972, are projected to increase about 16% annually through 1975, to \$1.6 billion. Interest on the Israeli foreign debt will increase to \$400 million – about 20% per year. Other service payments will rise by about 15% per year. A major portion of these payments – transport, insurance, and charter of ships and aircraft – is directly related to the flow of commodity trade. Consumer services, which make up only a small portion of the total, could double in the next three years because of the recent liberalization of restrictions on travel and other consumer use of foreign exchange.

Merchandise Exports³

16. Merchandise exports were valued at almost \$1.2 billion in 1972, slightly more than half of the \$2.2 billion of total exports of goods and services. They are projected to grow 15% annually through 1975 to a level of roughly \$1.8 billion.

17. Manufactured goods account for almost one-half of merchandise exports and are expected to be the fastest growing component of exports, increasing about 15%-20% annually in the period 1973-75. Exports of textiles and clothing – the largest single component of manufactured goods exports, representing about 14% of the total – probably will grow only by 10%-15% annually. Exports of processed foods, transportation equipment, and rubber products should also increase at this rate. The fastest expansion – 20% or more annually – is likely to be in chemicals, metal products, electrical and electronic equipment, plastics, and printed material.

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18. Exports of polished diamonds nearly doubled in value in the two-year period 1971-72, to \$385 million. A slowdown to about 15% annual growth is expected through 1975. Future gains will depend on the ability of Israeli firms to expand their present small share in the market for large stones. Availability of rough stones also may be a constraining factor. Production of rough stones is limited, and the DeBeers Central Selling Organization dominates distribution, rationing supplies among processors in various countries.

19. Agricultural exports, worth about \$155 million in 1972, probably will increase by only 5% a year during 1973-75. Exports of citrus fruit -- mainly oranges and grapefruit -- will face increasing competition in the European market from other Mediterranean producers.

20. Exports by the extractive industries, which account for only 4% of merchandise exports, will increase less rapidly than exports as a whole. Potash output, which accounts for 60% of extractive exports, now is nearly at full capacity, and additional capacity will not be available until 1974.

Services Exports

21. Exports of services have increased faster than merchandise exports, reaching a level of slightly more than \$1 billion in 1972, compared with \$387 million in 1967. Prospects are best for growth in tourism, investment income, and freight revenues. Services exports as a whole are likely to grow 20% in 1973 and 15% a year in 1974-75.

22. Tourism, the largest category in the services sector, accounted for \$210 million of foreign earnings in 1972, four times the 1967 level. In the absence of new episodes of terrorism, which slowed earnings in 1972, tourism should expand briskly, particularly with the expected influx of tourists in 1973 to celebrate Israel's 25th anniversary. Earnings from tourism probably will increase 20% in 1973 and 15% annually in 1974-75. Earnings by Israeli passenger carriers, which amounted to about \$95 million in 1972, will increase commensurately.

23. Investment income consists primarily of sizable earnings on Israel's expanding foreign exchange reserves. Earnings from this source were roughly \$90 million out of total investment income of \$165 million in 1972. The addition of nearly \$500 million to foreign exchange reserves in 1972, together with projected balance-of-payments surpluses in 1973 and 1974, will likely result in a doubling of investment income in 1973-75.

24. Freight earnings by Israel's growing fleet of freight carriers totaled \$155 million in 1972, almost three times 1967 earnings. The merchant fleet

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of more than 3 million deadweight tons will continue to increase in capacity through the mid-1970s, principally through the addition of three supertankers and several container ships now on order. Freight earnings should rise by 15%-20% annually through 1975.

25. Exports of other services, which account for more than one-third of the total, are projected to grow about 10% annually during 1973-75. Israel sells a sizable amount of engineering and construction services, primarily to less developed countries. In the communications field, Israeli firms not only sell equipment but design, install, and service nationwide systems, for example, in Iran. Israel Aircraft Industries sells maintenance and overhaul services to foreign airlines and air forces. In all these areas, Israel is in a favorable market position because it can sell the services of skilled people at lower prices than the United States or leading West European nations. Also in the service sector, Israeli insurance earnings are large and expanding.

Unilateral Transfers

26. Israel's unfavorable balance on current account is largely offset by substantial unilateral transfers from abroad - \$925 million in 1972. Personal transfers, made up largely of immigrants' transfers and pension payments from abroad, totaled \$335 million in 1972. These transfers grew most rapidly following the devaluation in August 1971 when immigrants from the United States and other states converted into pounds large amounts of capital held abroad. Such conversions are likely to continue through 1973, increasing personal transfer payments an additional 10%. During 1974-75, personal transfers are projected to increase about 5% annually.

27. Institutional transfers - that is, funds submitted to the Jewish Agency - swelled to \$300 million in 1972. More than two-thirds of these transfers were private US gifts channeled through the United Jewish Appeal to the Jewish Agency, a non-governmental body that spends its funds on social services in Israel. The balance was made up of private gifts to the Jewish Agency from other countries. The high level of transfers in 1972, which came in response to the appeal generated by Russian Jewish immigration, is not likely to be increased during 1973-75, and institutional transfers are projected to remain at \$300 million annually.

28. Personal restitution transfers to Israelis from the West German government were worth \$260 million in 1972. These payments, begun with the 1952 Luxembourg Treaty - the so-called "reparations agreement" -- are compensation payments to approximately 100,000 Israeli victims of Nazi persecution. Payments have more than doubled since 1967, both because of the revaluations of the German mark in 1969 and 1971 and because

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revisions in West German legislation have expanded compensation to victims not previously recognized. In 1973, payments are projected to rise 15%, mainly because of the recent devaluation of the dollar. Barring further currency realignments, these transfers to Israel are projected to increase about 5% annually during 1974-75.

29. US grant aid will continue into 1973 despite Israel's large projected payments surplus. Supporting assistance grants from the United States - worth \$30 million in 1972 - will total \$50 million in 1973. In the absence of foreseeable economic need, no grant aid is projected for 1974 and 1975.

Capital Account

30. Israel has received large amounts of capital in the form of long-term and medium-term loans and net foreign investment, which reached \$1.1 billion in 1972. Capital outflows for debt repayment in 1972 amounted to \$450 million, or about two-fifths of capital inflows. Loans, which comprise about 85% of the capital inflows, generally have concessionary terms. Therefore, as in 1972 when loans exceeded requirements for funds, Israel readily accepts the loans, using these funds to increase reserves. The interest earnings on the new balances normally exceed the "soft" charges made by the lenders. In 1973, capital inflows are projected to reach \$1.3 billion while outflows most likely will decline to \$420 million. Capital inflows should increase further in 1974 and decline slightly in 1975, whereas outflows should increase in both 1974 and 1975.

Foreign Investment

31. Net foreign investment in 1972 was \$195 million, more than double that in 1971, which had nearly tripled the amount in 1970. Foreign investment has been encouraged by the government policy of redeeming Israeli bonds at face value before they are due, provided that the proceeds are used in Israel. Little in Israel's present economic outlook suggests any decline in investment. In fact, the US Embassy reports, "In general, Israel is becoming more attractive to foreign investors, as area peace and the domestic boom continue and industrialization picks up steam." Foreign investment in 1973 probably will level off at \$200 million, as the extremely rapid rate of increase during the two preceding years is not likely to be duplicated. In 1974-75 a further increase of \$25 million annually would appear likely.

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32. In 1972, Israel received \$950 million in long-term and medium-term loans. US government loans, Israeli bond sales, and commercial credits represented more than 90% of the 1972 total. Loan receipts in 1973 are expected to reach \$1.1 billion, passing the billion dollar mark for the first time. In 1974, a small increase is expected, but a decline in 1975 should occur, bringing the total slightly below the 1973 amount.

33. Israel's major source of long-term and medium-term loans has been the US government. In 1972, the US government provided some \$400 million in loans, of which \$255 million was in the form of military credits. Some \$450 million is expected in 1973; a small reduction from this level is under consideration for 1974. Loans from the US government should decline in 1975, as Israel's need for foreign aid has declined and requirements for military equipment are slackening.

34. Israeli bond sales, primarily in the United States, made up roughly one-third of total 1972 loans. By 1975, bond sales are projected to increase to two-fifths of total loans and surpass US government loans as the major source of medium-term and long-term credit. The estimates of bond sales over the next three years may prove conservative, as the rates of increases projected are much lower than those of recent experience.

35. A large volume of commercial loans contracted by the private sector is primarily for the purchase of major capital equipment such as ships and aircraft. Because the importation of ships is expanding rapidly, commercial loans are forecast to increase to \$220 million in 1975, compared with \$125 million in 1972. Most commercial loans are obtained at favorable interest rates because they generally carry some Israeli government guarantees.

Debt Repayment Obligations

36. Debt repayment, which amounted to \$450 million in 1972, is projected to increase to \$550 million in 1975. Payments on the debt should decline in 1973 to \$420 million. In 1972, Israel made about \$100 million in unscheduled payments on debts carrying generally unfavorable terms. Therefore, scheduled repayments for 1973 normally would be below actual payments for 1972. During the next three years, Israel will have little motivation for increasing debt repayments above the scheduled amounts because most of the remaining loans are at interest rates below the rate of return on Israel's reserves.

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37. The discussion to this point has not distinguished between the foreign financial relations of Israel in its pre-1967 boundaries and in its current boundaries, which include the occupied territories. External commerce between the occupied territories and foreign countries is small compared with Israel's total foreign transactions. Trade moves between the occupied territories and Jordan, and through Jordan to other Arab countries. Imports are limited by the Israeli government, and exports are encouraged by subsidy payments. As a result, the occupied territories export about twice as much to other countries as they import from them. In 1971 the trade surplus amounted to \$17.4 million, with imports of only \$15.4 million. In 1972 the expansion of Arab tourism gave a solid boost to the surplus. Estimates from the government indicate that \$37 million was received from Arab tourists visiting the West Bank in 1972. The surplus on goods and services probably will not be increased in the next few years, as Jordan is taking measures to counteract export subsidies and as tourism probably will increase only gradually.

38. Transactions between the occupied territories and Israel proper are considered by the Israeli government to be internal transactions and therefore are excluded from the balance of payments. In 1971, Israel sold \$62 million worth of goods and services to the occupied territories - equal in value to 3% of Israel's total exports. This amount was \$25 million more than was paid to the occupied territories for goods and services, including salaries for imported Arab labor. Changes in these transactions in 1973-75 will not be large enough to have an appreciable impact on Israeli finances.

Problem Areas

39. Israel could conceivably encounter balance-of-payments difficulties in the next few years in spite of these favorable auguries. The projections in this memorandum assume a continuation of the cease-fire, expanding export markets, continued government policies to encourage exports and control imports, and continued support from sympathetic foreign governments and private individuals throughout the world. The rosy prognosis could be changed abruptly by factors reversing any of the above assumptions. Israel's record high foreign exchange reserves of more than \$1.2 billion, however, are sufficient to meet any short-term dislocations.

40. In the event of a step-up in Middle East hostilities, the most apparent impact would be an increase in military imports and a possible

⁴. Territory under the control of Israel as a result of the 1967 Arab-Israeli war.

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drop in foreign investment. The effect on the balance of payments would depend on the intensity, duration, and outcome of the hostilities. Military imports already are projected at a high level for 1973-74. Thus a low level of hostilities need not boost military imports to any great extent until 1975 or later. The impact of a shooting war on investment, of course, would be more immediate, depending also on the length of hostilities. For example, a short war might lead to the postponement of foreign investment, whereas a prolonged war could result in permanent losses of investment. As an offset, greatly increased military needs presumably would generate increased loans from friendly governments and transfer payments from supporters of Israel.

41. Other possible problems might involve a further worsening of the current account balance caused by a failure of exports to grow and/or an unchecked growth in civilian imports. Natural disasters affecting agricultural output, economic recessions in the United States and Western Europe and terrorist operations to discourage tourism are examples of developments that could depress export growth below the projected 15% annual rate. Even so, a zero rate of growth in exports would not change the projection of a balance-of-payments surplus through 1975. Civilian imports also could cause trouble if consumers put demands on the government to reduce import restrictions and if the high rate of domestic inflation makes imports substantially cheaper. Because consumer imports represent only a small part of total imports, even a high percentage increase might be manageable. Moreover, the recent devaluation of the Israeli pound will reduce the effect of domestic inflation on the competitiveness of domestic goods for the time being.

42. Israel could experience a reduction of support on the part of world Jewry. Israel receives through bond sales and transfers about \$650 million annually. Most of these bond sales are not motivated primarily by economic considerations; they increase in time of Israel's need. Thus the continued "no war, no peace" situation, together with favorable economic growth and a high level of foreign exchange reserves, could serve to curb the generosity of the world Jewish community. A moderate falling off in bond sales would merely reduce the projected payments surplus. If for some reason foreign support for Israel were sharply reduced, the effect on the balance of payments could be serious. The latter eventuality seems remote for the period of our projections.

A Brief Look Beyond 1975

43. If the assumptions of the above discussion continue to hold, Israel will not encounter any major balance-of-payments problems in the period after 1975. The current account deficit should continue to decline after 1975, provided that there are no new requirements for large military

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purchases. Foreign investment and the import of capital goods and equipment in the next three years will furnish the capacity for additional exports of goods and services. Civilian imports undoubtedly will continue to expand, yet the rate of growth is unlikely to outpace that for exports, and the trade deficit on civilian account should begin to decline. Israel should be able to handle any reasonably moderate changes in the level of unilateral transfers. Official long-term loans probably will fall off as Israel's foreign exchange reserves continue to expand. In summary, these trends beyond 1975 indicate a continuation of Israel's strong international financial position and a reduced dependence on foreign financing.

Implications for the United States

44. Military and economic aid from the United States has been instrumental in moving Israel from a deficit to a surplus position in its balance of payments. Beginning in late 1969, the first large-scale US military aid offset direct military imports. This assistance reached its highest level -- \$545 million -- during US fiscal year 1971 and was the principal cause of the sharp recovery of Israel's capital account in 1970. Loans under the PL-480 program, the largest component of US economic aid, were increased in 1970 by two-thirds to about \$50 million annually. The \$329 million in US loans in 1971 helped bring Israel its first balance-of-payments surplus since 1967, and US aid payments in 1972 were equal in value to 80% of the addition to foreign exchange reserves.

45. If surpluses in 1973-75 approach those projected in this memorandum, the continuation of US assistance at current levels will no longer be justified on economic grounds. US aid projected for 1973 totals \$500 million, including \$50 million in supporting assistance grants. Proposals for US aid for 1974 are still under consideration; they probably will be near or slightly below the 1973 level. Even in the absence of the projected US aid for 1973-74, Israel probably would maintain balance-of-payments surpluses of roughly \$150 million to \$200 million. In 1975 the surplus, without US aid payments, could be approximately \$350 million.

46. The Israeli government cites the need to accumulate large foreign exchange reserves because of a heavy dependence on imports as the reason for continued heavy foreign borrowing. Foreign exchange reserves at the end of 1972 had reached a level equal in value to one-third of annual imports of goods and services. Israel is not likely to restrain civilian or military imports so long as US support continues at present levels. Internal political pressures, which are accentuated by the advent of a general election in the fall of 1973, discourage the imposition of restrictions on the consumer or the military establishment unless absolutely necessary.

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CONFIDENTIAL**APPENDIX****Israel: Balance of Payments**

	<i>Estimated</i> 1972	<i>Projected</i>		
		1973	1974	1975
Current account	-1,000	-1,210	-1,330	-1,130
Trade balance	-490	-695	-810	-850
Exports of goods	1,180	1,360	1,565	1,800
Imports of goods	-1,670	-2,055	-2,375	-2,650
Of which:				
Indirect military imports	-170	-170	-170	-170
Balance of services account	-510	-515	-520	-280
Exports of services	1,020	1,225	1,410	1,620
Imports of services	-1,530	-1,740	-1,930	-1,900
Of which:				
Direct military imports	-500	-545	-545	-300
Unilateral transfers	925	1,020	1,005	1,040
Personal restitution from West Germany	260	300	315	330
Institutional remittances in cash	300	300	300	300
Personal remittances in cash	335	370	390	410
US assistance grant	30	50
Capital account	695	885	925	770
Net foreign investment	195	200	215	250
Net long-term and medium-term loans	500	685	700	520
Long-term and medium-term loans	950	1,105	1,150	1,070
Independence and development bonds	350	375	400	425
West German loans	45	50	50	50
US government loans	400	450	455	335
Of which:				
Military credits	255	300	300	175
World Bank and IMF	30	30	35	40
Other	125	200	210	220
Of which:				
Ships and aircraft	25	85	100	100
Debt redemption	-450	-420	-450	-550
Balance	620	695	600	680